

Tax Representation



TAXREP 69/08

PAYROLLING OF BENEFITS IN KIND:

SIMPLIFICATIONS NEEDED FOR BENEFITS-IN-KIND AND EXPENSES TO PAYROLL SUCCESSFULLY

Memorandum submitted in September 2008 by the Tax Faculty of the Institute of Chartered Accountants in England and Wales in response to an invitation from HMRC

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The Tax Faculty of the Institute of Chartered Accountants in England and Wales

TAXREP X/08
Finance Bill 2008

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FOREWORD

1. This memorandum responds to an invitation from HMRC at a meeting on 28 July 2008.
2. Details about the Institute of Chartered Accountants in England and Wales and the Tax Faculty are set out in Annex A. Our Ten Tenets for a Better Tax System which we use as a benchmark are summarised in Annex B

INTRODUCTION

3. We understand that an announcement may be made about payrolling benefits-in-kind and expenses ('bik') in the Pre-Budget Report 2008. We set out in this paper our recommendations in response to the invitation at a meeting on 28 July 2008 to provide 'specific comment on the simplifications that we believe will be required to taxable benefits in order for them to be successfully payrolled'. The points in this paper and our list of benefits are not necessarily exhaustive but are intended to illustrate the issues that need to be addressed.
4. We believe that the law governing how benefits in kind and expenses are charged to tax and NIC will need a lot of changes to make payrolling bik work in practice – these are explained below.
5. We suggest that the optimal solution would be to abandon compulsory statutory payrolling and, in order to satisfy the need for a statutory solution, introduce legislation allowing HMRC to enter into non-statutory informal agreements ('local arrangements') with employers under which employers payroll certain benefits, as currently, and to make an announcement to that effect in PBR 2008. Failing this, we suggest that the PBR 08 announcement confines itself to a statement that further work is needed and is being undertaken in conjunction with third party stakeholders with a view to making a full announcement at a later date. The later date need not be specified but, if it is, it would need to take into account the time needed to consider the large number of changes that would need to be made to the tax and NIC legislation governing benefits-in-kind and expenses in order to introduce a workable payrolling regime.

SIMPLIFICATIONS NEEDED: KEY POINT SUMMARY

6. For employers to be able in practice to payroll benefits and expenses without having to make subsequent or year-end adjustments and employees not to suffer reduced take-home pay in some pay periods making it impossible for them to budget for ongoing living costs, the following principles need to be applied:

- without exception, the taxable and NICable quanta of all benefits-in-kind and taxable and NICable expenses that have to be payrolled in a pay period need to be capable of being determined once-and-for-all by the first day of the pay period, failing which they should be returned on end-of-year forms or exempted from tax and NIC;
- expenses reimbursed to employees that are deductible from remuneration in the hands of employees should not be payrolled; and
- employees' take home pay should not reduce below a set proportion of gross cash pay – say 50% as presently applies for income tax – as a result of payrolling benefits and expenses; thus the 50% K-code rule should apply to NIC as well as income tax.

7. The first principle will necessitate consideration of and probably changes to the policy and law underlying the taxation and NICing of every benefit-in-kind and taxable and/or NICable expense, but is essential if payrolling on a statutory basis is to be possible by employers without their having to take professional advice every month. As to the second, consideration will be required of those instances where the tax rules for expenses and the NIC rules for expenses either produce different answers and/or require different procedures to be followed to reach what might be the same answer.

GENERAL COMMENTS

8. For benefits to be payrolled successfully in real time employers would need to be able to quantify the amount of the benefit once, and once only, sufficiently early in the pay period to meet employee pay deadlines. Subsequent or post year-end adjustments must not be required. Consequently, we recommend that, without exception, the taxable and NICable quantum of all benefits and expenses that are to be payrolled in a pay period must be capable of being determined by the first day of the pay period (as in Germany).
9. It must be recognised that this would produce hard cases from the perspective of some employees whose car or loan balance might change after the relevant date and vice versa when a benefit is provided ab initio or increased. Changing the charging rules so that benefits are taxed and NICed only where they are in payment and have an ascertainable value on the first day of the pay period could lead to behavioural changes, so that, for example, benefits are awarded or increased on the second day of the pay period and withdrawn or reduced on the last day of a pay period, but we consider that this is the price that must be paid if the benefits tax and NIC rules are to be changed to make it possible for employers to collect tax and NIC on benefits in real time.
10. It would also make the position for leavers simpler as in the normal case there would be no need for the employer to make subsequent adjustments to the payroll for bik changes within the leaver's final pay period. However, it might be felt necessary to introduce an anti-avoidance measure to prevent major bik being provided in that final pay period which otherwise would escape tax and NIC.
11. We accept that levying a charge based on the bik as at the first day of the pay period leaves open the question of how to tax and charge NIC on benefits and expenses provided during a pay period which cannot be ascertained by the first day thereof. The simplest solution is likely to be for employers to report these other items to

HMRC on a separate return such as form P11D at the end of the tax year, as at present, using the current P11D deadlines.

12. Another option is to have a prior pay period basis, under which the benefits and expenses to be payrolled in any pay period are those received in, say, the previous pay period (eg benefits received in March would be payrolled in April). We do not favour this. Even though it may not necessitate quite so many changes to the rules governing the quantification of taxable/NICable benefits to achieve our first principle of benefits being quantifiable by the first day of the pay period, it would both leave open the question of how to tax and charge NIC on benefits and expenses provided in the final the pay period of an employee's employment and not bring finality where valuations can be reopened. Although an end-of-year return is likely to be the simplest answer, it seems to defeat the object of payrolling if, for leavers, potentially one twelfth of a year's benefits have to be returned on a year-end form, and having to complete one-off end-of-year returns for leavers would be disruptive for employers.
13. Another principle is that employees' take home pay should not fluctuate to such an extent that they cannot budget for living expenses or, at worst, be reduced to nothing as a result of payrolling benefits and expenses
14. At present, fluctuations in take home pay across pay periods are largely eliminated because the benefits on which tax is collected are total taxable benefits and expenses for (normally) one past year and this figure is fixed (subject to code number changes). However, if benefits and expenses are payrolled in-year, then, where benefits and expenses are one-off or uneven, for example where ownership of an asset is passed to an employee, or utility bills for job-related accommodation are paid and the 10% of annual pay threshold is breached, or taxable expenses are paid, then the amount of 'gross pay' on which tax and NIC will be charged may increase significantly in that pay period leading to a significant reduction in take-home cash pay.
15. In order to protect employees' take-home pay from being reduced to below 50% of gross pay where tax and NIC is correctly deducted in a pay period, the existing income tax rule (applied mainly where a K code applies) whereby not more than 50% of gross pay can be taken off as tax needs to be extended across to NIC. We also consider that employers should be able more easily to recover Class 1 NIC on non-cash items, and again the NIC rules need to be aligned with the income tax rules
16. We also consider that where expenses are paid which are allowable (ie, deductible from remuneration in the hands of the employee), then these should be omitted from the payroll and returned on P11D or covered by dispensations or PAYE settlement agreements (PSAs). Obtaining these should be made simpler for employers including owner-managed companies.
17. We recommend that HMRC should publish a list of allowable round-sum subsistence and accommodation allowances for the UK. In the interests of simplicity, such list should provide just two rates, one for the capital and the other for outside London, as has been done for the overseas lists. Any perceived over-generosity in the rates is likely to be compensated for by employers setting the rates that they pay to employees to less than the rates cited on HMRC's list in order to save money. This will facilitate and simplify the granting/renewing of dispensations and PSAs and reduce on-going employer administration and the need for HMRC audit.

18. In some circumstances, for example where assets or shares are transferred to employees, the employer and HMRC currently need to agree a valuation. If such benefits are to be payrolled, then they should be capable of being valued by the employer once-and-for-all. They could be valued on a self-certified basis, as presently happens for NIC in respect of readily-convertible assets where the employer's best reasonable estimate is the final figure, or by way of a formula. Otherwise they should be left out of payroll and included, as at present, in an end-of-year return (as in Ireland where, for example, share scheme benefits are returned on their form P11D). Given the fact that assets and shares can be transferred to employees at any time in a pay period which does not reconcile with our principle that the taxable and NICable quanta of all benefits that are to be payrolled in a pay period need to be ascertainable by the first day of the pay period, it would be more practical to leave these out of payroll and include them on an end-of-year return .
19. The exemptions relating to some benefits which are taxable may need to be widened to allow payrolling to work in practice. Examples include season ticket loans (we suggest that these should be totally exempt so employers do not have to consider the £5,000 de minimis), taxis (conditions for exemption should take into account the personal safety of employees, especially late at night) and medical checkups/ screening (preventative medicine should be exempt unconditionally – employers in general do not spend money unnecessarily).
20. We have not covered NICs in depth in this paper but if payrolling is proceeded with then the charge to NIC will also need to be considered. We understand that:
- It is not proposed to change the respective charges to Classes 1 and 1A NIC on benefits.
However, there is scope to eliminate the Class 1/Class 1A divide, for example, cars are liable to Class 1A but travel is liable to Class 1; and telephones, medical, et al can be either depending on precise circumstances, for example, in whose name is the contract. Similarly, fuel purchases by company credit card are liable to Class 1 NIC unless the employee agrees with the filling station before putting in the fuel that he is buying on behalf of the company and the filling station agrees to this.
 - Reporting and collection of Class 1A NIC will remain as it is now.
However this will mean that some bik will be payrolled for income tax but included on an end-of-year return for Class 1A NIC which, whilst preserving the cash flow advantage to the employer arising from the due date for payment of Class 1A, will not obviate the need for the employer to have to process the same bik twice, once in the payroll and once on an end-of-year return.

SPECIFIC BENEFITS

21. We set out in the table below our observations on the tax treatment of some commonly-provided benefits. They seem to fall into two categories, first those which, with some tweaking to the rules, could perhaps be payrolled, eg company cars and fuel, medical insurance and living accommodation, and secondly those which cannot be payrolled, unless a prior pay period basis is used, because they arise during the pay period so it would be too late to process the information, eg transfers of assets and shares, expenses generally and training and relocation expenses, which it would probably be best to continue to report by way of an end-of-year return.

22. Observations on the tax (not NIC) treatment of some specific commonly-provided benefits.

	<u>Current tax treatment</u>	<u>Proposed Tax treatment if payrolled</u>	<u>Comments</u>
Accommodation: Job-related: utility bills	Quantum limited to 10% of annual pay	In view of lumpy quality of utility bills, probably impractical to payroll, so return on P11D	
Assets with no obvious second-hand value: ownership transferred to employees	Value – subject to subsequent negotiation with HMRC if HMRC don't agree	As it is not possible to predict when assets will be transferred, return on P11D.	Even allowing value to be agreed by reference to formula or employer self-certification with no subsequent adjustment it would still not be possible to payroll as transfers take place within pay period and often after the payroll run is complete.
Assets belonging to employer used by employees	Deemed cash equivalent of private use element over the course of a year	Value per formula or employer/ee self-certification with no subsequent adjustment – otherwise return on P11D	Removes need for subsequent change
Cars & vans	Scale rate based on availability on each day in tax year	Scale rate based on availability on first day of pay period	Removes need for crystal ball
Fuel	Scale rate based on availability on each day in tax year	Scale rate based on availability at start of pay period	Removes need for crystal ball
Cars & fuel for those in motor trade who can use a different vehicle daily	Scale rate based on availability on each day in tax year	Value per formula based on scale rates? Probably impractical to payroll, so return on P11D	
Loans: beneficial	Interest differential on: <ul style="list-style-type: none"> Average loan at start & end of tax year, or <ul style="list-style-type: none"> On each day subject to cliff edge de 	1. Loan at start of pay period for duration of pay period subject to non-cliff edge de minimis 2. save for season ticket loans which should be entirely exempt	1. Removes need for crystal ball. 2. encourages use of public transport

	minimis of £5k and purpose of loan		
Medical checks/screens	Cost subject to exemption if conditions met	Make exempt	As a policy, prevention is best medicine and early diagnosis minimises cost of cure
Medical insurance	Cost attributed to individuals over period paid for	If it is to be taxable, cost attributed to individuals over period paid for. (NB: cf suggestion in condoc of spreading over remainder of tax year.)	
Parties	Cost, depending on who and how many attend, subject to de minimis of £150, and incl. transport	Impractical to payroll in real time, so return on P11D	Many employers prefer to include in PSA anyway
Relocation expenses etc	Taxable if over £8,000	Impractical to payroll – which is why currently excluded from payrolling	
Share scheme gains, options leading to s.222 benefit	Value – subject to subsequent negotiation with HMRC if HMRC don't agree	As it is not possible to predict when shares, etc will be transferred, return on P11D.	Even allowing value to be agreed by reference to formula or employer self-certification with no subsequent adjustment would not enable payrolling as transfers take place within pay period and often after the payroll run is complete.
Taxis late at night	Cost unless five conditions for exemption met	1. Exemption should cover personal safety of employee. 2. Impractical to payroll in real time, so return on P11D	1. Would increase acceptability of charge
Training costs	Cost, but exempted depending on conditions	Impractical to payroll in real time, so return on P11D	

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ICAEW AND THE TAX FACULTY: WHO WE ARE

1. The Institute of Chartered Accountants in England and Wales (ICAEW) is the largest accountancy body in Europe, with more than 128,000 members. Three thousand new members qualify each year. The prestigious qualifications offered by the Institute are recognised around the world and allow members to call themselves Chartered Accountants and to use the designatory letters ACA or FCA.
2. The Institute operates under a Royal Charter, working in the public interest. It is regulated by the Department for Business, Enterprise and Regulatory Reform through the Financial Reporting Council. Its primary objectives are to educate and train Chartered Accountants, to maintain high standards for professional conduct among members, to provide services to its members and students, and to advance the theory and practice of accountancy, including taxation.
3. The Tax Faculty is the focus for tax within the Institute. It is responsible for tax representations on behalf of the Institute as a whole and it also provides various tax services including the monthly newsletter *TAXline* to more than 10,000 members of the ICAEW who pay an additional subscription.
4. To find out more about the Tax Faculty and ICAEW including how to become a member, please call us on 020 7920 8646 or email us at taxfac@icaew.com or write to us at Chartered Accountants' Hall, PO Box 433, Moorgate Place, London EC2P 2BJ.

THE TAX FACULTY'S TEN TENETS FOR A BETTER TAX SYSTEM

The tax system should be:

1. **Statutory:** tax legislation should be enacted by statute and subject to proper democratic scrutiny by Parliament.
2. **Certain:** in virtually all circumstances the application of the tax rules should be certain. It should not normally be necessary for anyone to resort to the courts in order to resolve how the rules operate in relation to his or her tax affairs.
3. **Simple:** the tax rules should aim to be simple, understandable and clear in their objectives.
4. **Easy to collect and to calculate:** a person's tax liability should be easy to calculate and straightforward and cheap to collect.
5. **Properly targeted:** when anti-avoidance legislation is passed, due regard should be had to maintaining the simplicity and certainty of the tax system by targeting it to close specific loopholes.
6. **Constant:** Changes to the underlying rules should be kept to a minimum. There should be a justifiable economic and/or social basis for any change to the tax rules and this justification should be made public and the underlying policy made clear.
7. **Subject to proper consultation:** other than in exceptional circumstances, the Government should allow adequate time for both the drafting of tax legislation and full consultation on it.
8. **Regularly reviewed:** the tax rules should be subject to a regular public review to determine their continuing relevance and whether their original justification has been realised. If a tax rule is no longer relevant, then it should be repealed.
9. **Fair and reasonable:** the revenue authorities have a duty to exercise their powers reasonably. There should be a right of appeal to an independent tribunal against all their decisions.
10. **Competitive:** tax rules and rates should be framed so as to encourage investment, capital and trade in and with the UK.

These are explained in more detail in our discussion document published in October 1999 as **TAXGUIDE 4/99**; see <http://www.icaew.co.uk/index.cfm?route=128518>.